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Economic & Market Summary
October 2021

The Delta variant has slowed, not stalled the recovery. GDP growth estimates for the third quarter have come down but remain at levels well-above the pre-COVID trend. The economy has bounced back quickly and is actually slightly larger than it was pre-COVID. We expect healthy growth to continue with the pandemic having less influence over time.

With the economy healing, the Federal Reserve will likely taper its monthly bond purchases before year-end. This begins the process of removing the economy from emergency support. Overall policy will remain highly accommodative. The Fed has made it clear the bar to raising interest rates, a more impactful policy tool than bond purchases, is much higher. Maximum employment must be obtained while inflation should rise to 2% and be on pace to "moderately exceed" 2% "for some time."

The labor market has made substantial progress. About three quarters of the pandemic-related job losses have returned. On average, payrolls have risen about 561K per month this year. At this pace, the remaining gap will close by mid-2022, potentially achieving the Fed's goal of maximum employment. A shortage of available workers is the biggest challenge facing the labor market. There's currently less than one unemployed person per job opening. Possible explanations include virus concerns, increased retirements, and mismatched skills. The Fed is focused on the labor recovery even though core inflation is elevated at 4% annualized. This certainly clears the "rise to 2%" bar. However, the Fed believes the inflationary uptick is pandemic-driven and therefore transitory. With labor shortages, rising raw material costs, and other supply chain bottlenecks, high inflation could persist and put upward pressure on historically low bond yields.

We're concerned about the $3.5T spending plan under consideration by Congress. It adds to the government's already substantial debt load. Federal debt to GDP is at the highest level since WWII. The proposed tax increases on corporate earnings, dividends, and capital gains would negatively impact long-term economic growth in our view. The administration's domestic policies reflect two broad themes: first, a more significant role for government socially and economically and second, tighter regulations for big businesses. Well-intended regulations can come with undesirable side effects. This is something to monitor closely.

Strong demand and improved profit margins have driven up 2021 and 2022 earnings estimates for S&P 500 companies. However, forecasts may not reflect rising input costs and higher corporate taxes. Estimates could come down as companies report third quarter earnings and update guidance in the coming weeks. With the S&P 500 trading at an elevated valuation of 21x forward earnings, falling estimates and rising bond yields could pressure stock prices near-term. However, corrections are normal in a healthy bull market and create buying opportunities for long-term investors. Even in an inflationary environment, high-quality companies are sound investments. We focus on businesses with sustainable competitive advantages that lead to durable pricing power which supports long-term revenue and earnings growth.

Mark J. Sprtel, CFA

If you're financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.